TRANSPORTATION

I. OVERVIEW

This Program Memorandum covers Transportation, the third of eleven major programs in the statewide program structure.

The overall objective of the Transportation program is to facilitate rapid, safe, and economical movement of people, goods, and mail into, within, and out of the State by providing and operating transportation facilities and supporting services.

The Transportation program is composed of four principle sub-programs: Air Transportation Facilities and Services, Water Transportation Facilities and Services, Land Transportation Facilities and Services, and Overall Program Support for Transportation Facilities and Services. A total of 35 individual, lower-level programs and their associated plans are included in the Multi-Year Program and Financial Plan for the period 2005-2011.

The Department of Transportation (DOT) is the only State organizational entity involved in the Transportation program. Federal agencies involved include: Federal Aviation Administration; Treasury Department; Department of Agriculture; Department of Commerce; Department of Health and Human Services; Department of Homeland Security; Department of Interior; U.S. Army Corps of Engineers; U.S. Coast Guard; Federal Highway Administration; Federal Transit Administration; Federal Maritime Commission; Transportation Security Administration; and Environmental Protection Agency. In terms of financial assistance, the U.S. Department of Transportation is the most important of the federal agencies involved. Because county transportation systems must complement the State transportation system, the County Planning Commissions and the respective Departments of Planning and Public Works assist in determining needs and priorities of transportation facilities. In addition, the City and County of Honolulu performs maintenance activities on all traffic lights on Oahu and removes abandoned vehicles from State highways.

DOT must plan, design, construct, operate and maintain State facilities in all modes of transportation, including air, water, and land. Coordination with other State, county and federal programs is maintained in order to achieve objectives. The program currently provides, operates, and maintains

eleven (11) commercial service airports, four (4) general aviation airports; ten (10) commercial harbors; and two thousand three hundred eighty-one (2,381) lane miles of highway. Four of the five major airports now serve domestic overseas carriers.

The Transportation program and its sub-programs are significantly affected by environmental concerns. Pollution controls, for example, increase operating and maintenance costs and can cause significant modifications, delays, or even cancellations of plans or projects. Changes in technology significantly affect requirements needed in facilities, as do increases in volume requirements. The program strives to reduce its dependence on various energy resources and is continuously reviewing conservation measures to reduce costs and become more energy efficient.

The Transportation program is also affected by economic conditions. Recession and expansionary cycles affect air travel and in turn, tourist arrivals and cargo shipments. Fluctuations in currency exchange rates also affect the number of overseas passenger arrivals and volume of imported and exported goods.

Table I-1 shows the operating and capital improvement project costs for the Transportation program over the budget and planning period. It should be noted that capital improvement project costs are not reflected for the planning period because projects are under review.

TABLE I-1

INVESTMENT AND OPERATING COSTS

TRANSPORTATION

	Fiscal Years							
	Actual 2003-04	Est. 2004-05	Rec. 2005-06	Rec. 2006-07	Projected 2007-08	2008-09	2009-10	2010-11
A. Costs of the Recommended Program[A/]								
Capital Investment	285.1	383.2	356.6	361.6	...	...	...	...
Operating	460.8	593.7	607.7	602.5	603.1	608.7	606.0	610.1
Total	745.9	976.9	964.3	964.1	603.1	608.7	606.0	610.1

A/ Expenditures in millions of dollars from all funds.

II. COSTS AND EFFECTIVENESS OF THE RECOMMENDED PROGRAMS

This section discusses the activities, costs and effectiveness of the major Level III programs, which constitute the Transportation program.

AIR TRANSPORTATION FACILITIES AND SERVICES

The objective of the Level II program, Air Transportation Facilities and Services, is to develop, manage, and maintain a safe and efficient statewide airport system with the spirit of aloha for Hawaii's residents and visitors. A total of 15 individual lowest-level programs and their associated plans are included in the Multi-Year Program and Financial Plan for the period 2005-2011.

The statewide airport system consists of 11 airports serving commercial airlines and general aviation flights, and 4 general aviation airports. Honolulu International Airport (HIA), Kahului Airport, Lihue Airport, and Kona International Airport at Keahole are the only airports serving domestic overseas and international carriers.

Revenues for the Air Transportation Facilities and Services program are derived from concession fees, aviation fuel taxes, building space and land rentals, investment income, landing fees, airport use charges, federal grants and other sources. Committees composed of representatives from airlines and concessionaires act in an advisory capacity in reviewing airport operational plans and capital improvement program projects.

Several non-State government agencies are involved in monitoring and controlling activities within the airport system. The Federal Aviation Administration (FAA) must certify that each airport serving scheduled air carriers properly conforms to applicable safety and security standards. The FAA provides air traffic control services for airports at Honolulu, Hilo, Kona, Kahului, Molokai, and Lihue. Since HIA, Kona, Lihue, and Kahului serve both domestic and international flights, the U.S. Immigration and Naturalization Service, Public Health Service, Department of Agriculture, U.S. Customs and Border Patrol Service, Transportation Security Administration (TSA) and U.S. Fish and Wildlife Service are involved in border clearance activities for travelers and cargo.

For passenger convenience, Hilo, Kona, Kahului, Lanai, and Lihue Airports have a state funded U.S. Department of

Agriculture pre-departure program to inspect baggage of passengers bound for the mainland who depart from these airports and interline or pass through HIA.

Cost data for the Air Transportation Facilities and Services program are shown in Table II-1. It is noted that capital investment costs for the planning period are not reflected because projects are under review.

TABLE II-1

INVESTMENT AND OPERATING COSTS
AND
MEASURES OF EFFECTIVENESS/ACTIVITY

AIR TRANSPORTATION FACILITIES AND SERVICES

	Fiscal Years							
	Actual	Est.	Rec.	Rec.	Projected			
	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
A. Costs of the Recommended Program[A/]								
Capital Investment	63.9	125.7	127.6	94.3	...	...	...	...
Operating	238.8	328.2	267.7	268.7	268.7	268.7	268.7	268.7
Total	302.7	453.9	395.3	363.0	268.7	268.7	268.7	268.7
B. Selected Measures of Effectiveness/ Activity								
Honolulu International Airport								
Avg. Time from Passengers Entering to Plane Take-off (Minutes)	150	150	150	150	150	150	150	150
Total Through-Put Cost (cents)	420	484	456	481	476	471	466	462
Passengers (000)	18,900	19,089	19,280	19,473	19,667	19,864	20,063	20,263
Cargo (000 tons)	354	358	361	365	368	372	376	380
Aircraft Operations (000)	205	207	209	211	213	215	218	220

A/ Expenditures in millions of dollars from all funds.

TABLE II-1 - Continued

	Fiscal Years							
	Actual	Est.	Rec.	Rec.	Projected			
	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
B. Selected Measures of Effectiveness/ Activity - Continued								
Hilo International Airport								
Avg. Time from Passengers Entering to Plane Take-off (Minutes)	90	90	90	90	90	90	90	90
Total Through-Put Cost (cents)	781	1,204	1,119	371	862	853	845	836
Passengers (000)	1,200	1,212	1,224	1,236	1,249	1,261	1,274	1,287
Cargo (000 Tons)	18	18	18	19	19	19	19	19
Aircraft Operations (000)	101	102	103	104	105	106	107	108
Kahului Airport								
Avg. Time from Passengers Entering to Plane Take-off (Minutes)	97	97	97	97	97	97	97	97
Total Through-Put Cost (cents)	295	339	288	246	243	241	238	236
Passengers (000)	6,728	6,795	6,863	6,932	7,001	7,071	7,142	7,213
Cargo (000 Tons)	51	52	52	53	53	54	54	55
Aircraft Operations (000)	154	156	157	159	160	162	163	165
Lihue Airport								
Avg. Time from Passengers Entering to Plane Take-off (Minutes)	85	85	85	85	85	85	85	97
Total Through-Put Cost (cents)	492	502	495	656	650	643	637	631
Passengers (000)	2,522	2,547	2,573	2,598	2,624	2,651	2,677	2,704
Cargo (000 Tons)	15.1	15.2	15.4	15.6	15.7	15.9	16.0	16.2
Aircraft Operations (000)	103	104	105	106	107	108	109	110

WATER TRANSPORTATION FACILITIES AND SERVICES

The objective of the Level II program, Water Transportation Facilities and Services, is to provide and effectively manage a commercial harbor system that facilitates efficient movement of people and goods to, from and between the Hawaiian Islands, and enhances and/or preserves economic prosperity and quality of life. A total of eleven individual, lowest-level programs and their associated plans are included in the Multi-Year Programs and Financial Plan for the period 2005-2011.

The program consists of: improvement, operation, and maintenance of the statewide harbor system which consists of ten commercial harbors (Honolulu, Kewalo Basin, Kalaeloa Barbers Point, Nawiliwili, Port Allen, Kahului, Kaunakakai, Kaumalapau, Hilo, and Kawaihae); and program leadership and staff support services, including planning and administration for the statewide harbors system.

The primary activity within the statewide harbors system is handling of containers, automobiles, equipment, and bulk and general cargo. The cargo handling facilities are improved and maintained to meet cargo volume. The growth of passenger ship activity and the need for berthing and terminal space, the proposed introduction of inter-island ferry operations in 2007, and continued growth of cargo have also increased harbor facility requirements.

The Water Transportation Facilities and Services program is financed through revenues derived from wharfage, rentals, dockage, port entry fees, mooring charges, demurrage, cleaning, and other charges. Wharfage and rentals are the largest sources of revenue.

Federal programs related to the Water Transportation Facilities and Services program include the programs of the U.S. Army Corps of Engineers, which administers and participates in planning, construction, and maintenance of harbor navigational improvements. The Federal Maritime Commission regulates ports and marine terminal operators engaged in United States ocean borne commerce and receives and reviews tariff filings. The U.S. Coast Guard oversees maritime security at commercial harbors and is also involved in enforcement of safety and oil pollution regulations within harbor complexes of the State. The U.S. Treasury Department inspects foreign goods to insure a proper assessment of duty. Goods are also inspected by the U.S. Department of Agriculture to safeguard the State against introduction of biological pests. The U.S. Customs and Border Patrol monitors the flow of foreign people and goods through State ports. The

Environmental Protection Agency is involved with water quality standards.

Cost data for the Water Transportation Facilities and Services program are shown in Table II-2. It is noted that capital investment costs for the planning period are not reflected because projects are under review.

TABLE II-2

INVESTMENT AND OPERATING COSTS
AND
MEASURES OF EFFECTIVENESS/ACTIVITY

WATER TRANSPORTATION FACILITIES AND SERVICES

	Fiscal Years							
	Actual	Est.	Rec.	Rec.	Projected			
	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
A. Costs of the Recommended Program[A/]								
Capital Investment	47.1	50.1	58.7	60.0	...	...	...	...
Operating	60.5	69.5	79.7	79.3	79.4	79.4	79.4	79.4
Total	107.6	119.6	138.4	139.3	79.4	79.4	79.4	79.4
B. Selected Measures of Effectiveness/ Activity								
Honolulu Harbor								
Program Cost Per Ton of Cargo (Water)	1.41	1.67	1.68	1.68	1.68	1.68	1.68	1.68
Total Cargo Tons Processed Per Acre Excl. Water Areas	35,230	35,302	35,935	36,008	36,653	36,728	37,386	37,463
Number of Passengers	381,000	190,000	294,000	398,000	398,000	398,000	398,000	398,000

A/ Expenditures in millions of dollars from all funds.

TABLE II-2 - Continued

	Fiscal Years							
	Actual	Est.	Rec.	Rec.	Projected			
	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
B. Selected Measures of Effectiveness/ Activity - Continued								
Hilo Harbor								
Program Cost Per Ton of Cargo	.96	1.25	1.32	1.32	1.32	1.32	1.32	1.32
Total Cargo Tons Processed Per Acre Excl. Water Areas	76,000	71,350	72,777	74,233	75,717	77,232	78,776	80,352
Number of Passengers	389,000	300,000	404,000	508,000	508,000	508,000	508,000	508,000
Kahului Harbor								
Program Cost Per Ton of Cargo	.42	.87	.86	.86	.86	.86	.86	.86
Total Cargo Tons Processed Per Acre Excl. Water Areas	81,000	82,000	83,640	85,313	87,019	88,759	90,535	92,345
Number of Passengers	235,000	200,000	75,000	75,000	75,000	75,000	75,000	75,000
Nawiliwili Harbor								
Program Cost Per Ton of Cargo	1.66	2.65	2.78	2.78	2.78	2.78	2.78	2.78
Total Cargo Tons Processed Per Acre Excl. Water Areas	19,700	19,600	19,992	20,392	20,800	21,216	21,640	22,073
Number of Passengers	161,000	218,000	322,000	420,390	420,390	420,390	420,390	420,390

LAND TRANSPORTATION FACILITIES AND SERVICES

The objective of the Level II program, Land Transportation Facilities and Services, is to provide a safe and efficient highway system through utilization of available resources and maintenance, enhancement, and support of land transportation facilities and programs. A total of eight lowest-level programs and their associated plans are included in the Multi-Year Program and Financial Plan for the period 2005-2011.

The program consists of development, operation, maintenance, improvement and administration of the statewide highway system consisting of approximately 2,381 lane miles of highway. Also included is the Safety Administration of Land Transportation program.

The federal government, through the U.S. Department of Transportation's Federal Highway Administration (FHWA) and Federal Transit Administration (FTA), provides guidance and support to state highway agencies in developing and operating their highway facilities. The State Highways Division initiates and administers State highway system projects. FHWA is responsible for reviewing and approving the amount and timing of federal aid funding for State highway projects. The National Highway Traffic Safety Administration establishes and monitors highway safety standards while county planning and public works departments are involved in planning and programming various phases of highway construction for county highway projects. County police departments assist in enforcing traffic regulations.

The FTA, under various programs, provides funding to states to support public transportation. The assistance ranges from funding transit operations and facilities to assisting private nonprofit groups in meeting needs of the elderly and persons with disabilities.

These programs also interface with the Oahu Metropolitan Planning Organization as part of an overall comprehensive and coordinated planning process for all Oahu highway projects as well as airport and harbor projects.

The Land Transportation Facilities and Services program is financed by the State motor fuel tax, rental motor vehicle and tour vehicle surcharge, State vehicle weight tax, State vehicle registration fee, and federal-aid funding for highway projects. The Capital Improvement Program budget is financed by revenue bonds, the highway special fund, and federal-aid

funding. Capital Improvement Program projects are also supported by general obligation bond fund appropriations.

Revenues derived from fuel taxes include the following: 16 cents per gallon for gasoline, 1 cent per gallon for diesel oil (off highway), 16 cents per gallon for diesel oil (highway use) and 11 cents per gallon for liquid petroleum gas (highway use). The State vehicle weight tax rates are: 0-4,000 pounds, .0075 cents per pound; 4,001-7,000 pounds, .0100 cents per pound; 7,001-10,000 pounds, .0125 cents per pound; 10,001+ pounds, $150.00 per vehicle. The vehicle registration fee is $20.00 per vehicle.

Act 263/91 authorized the rental motor vehicle tax and Act 223/99 established the tour vehicle surcharge tax. The current rates are as follows: motor vehicle rental, $3.00 per day (reverts back to $2.00 a day effective August 31, 2007) levied upon the lessor; tour vehicles 8-25 passengers, $15.00 per month; and tour vehicles over 25 passengers, $65.00 per month, levied upon the tour vehicle operator.

Major activities of the program include delivery of highway Capital Improvements Program projects, which averages $120-170 million annually. The Highways Division also provides significant support services for all four counties in processing county and federal aid projects annually. Operations of the State highway system consist of maintaining the statewide system of highways throughout the four counties with a staff of 1,034 positions. The major objective is to provide safe and reliable highway facilities for public use.

Federal legislation that authorized the federal-aid highway program for Fiscal Years 1998 through 2003 - known as the Transportation Efficiency Act for the 21st Century (TEA-21) - expired on September 30, 2003. Congress has been struggling to pass new multi-year legislation. It was unable to do so in FY 2004. Assuming no significant changes are made to the apportionment formulas used to distribute funds among states, the State's annual federal program in future years is estimated to be in the neighborhood of $140 million to $150 million. However, the amount of funds that Congress allows the states to obligate each year (obligation limitation) is generally less than the funds apportioned. In the past, the obligation limitation has been approximately 90% of the apportionment.

Cost data for the Land Transportation Facilities and Services program are shown in Table II-3. It is noted that capital investment costs for the planning period are not reflected because projects are under review.

TABLE II-3

INVESTMENT AND OPERATING COSTS
AND
MEASURES OF EFFECTIVENESS/ACTIVITY

LAND TRANSPORTATION FACILITIES AND SERVICES

	Fiscal Years							
	Actual 2003-04	Est. 2004-05	Rec. 2005-06	Rec. 2006-07	Projected 2007-08	2008-09	2009-10	2010-11
A. Costs of the Recommended Program[A/]								
Capital Investment	174.3	207.4	170.3	207.3	...	...	...	...
Operating	146.6	180.5	242.8	237.0	237.5	243.2	240.4	244.6
Total	320.9	387.9	413.1	444.3	237.5	243.2	240.4	244.6
B. Selected Measures of Effectiveness/ Activity								
Oahu Highways								
Maint. Cost Per 10-Lane Miles (Dollars)	166,511	191,734	191,734	191,734	191,734	191,734	191,734	191,734
Roadway Maint. - Lane Miles	1,150	1,150	1,150	1,150	1,150	1,150	1,150	1,150
Landscape Maint. - Acres	2,254	2,254	2,254	2,254	2,254	2,254	2,254	2,254
Structure Maint. - Number	442	442	442	442	442	442	442	442

A/ Expenditures in millions of dollars from all funds.

TABLE II-3 - Continued

	Fiscal Years							
	Actual	Est.	Rec.	Rec.	Projected			
	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010 11
B. Selected Measures of Effectiveness/ Activity - Continued								
Hawaii Highways								
Maint. Cost Per 10-Lane Miles (Dollars)	87,880	110,359	110,359	110,359	110,359	110,359	110,359	110,359
Roadway Maint. - Lane Miles	771	774	775	785	795	795	795	795
Landscape Maint. - Acres	1,416	1,416	1,434	1,434	1,440	1,440	1,440	1,440
Structure Maint. - Number	132	133	138	138	145	145	145	145
Maui Highways								
Maint. Cost Per 10-Lane Miles (Dollars)	104,430	127,537	127,537	127,537	127,537	127,537	127,537	127,537
Roadway Maint. - Lane Miles	416	420	420	431	431	431	431	431
Landscape Maint. - Acres	260	260	260	260	260	260	260	260
Structure Maint. - Numbers	100	100	100	100	100	100	100	100
Kauai Highways								
Maint. Cost Per 10-Lane Miles (Dollars)	140,297	140,590	140,590	140,590	140,590	140,590	140,590	140,590
Roadway Maint. - Lane Miles	272	272	272	272	272	272	272	272
Landscape Maint. - Acres	719	719	719	719	719	719	719	719
Structure Maint. - Number	49	49	49	49	49	49	49	49

OVERALL PROGRAM SUPPORT FOR TRANSPORTATION FACILITIES AND SERVICES

The objective of the Level II program, Overall Program Support for Transportation Facilities and Services, is to enhance the effectiveness and efficiency of the Transportation Program by providing program leadership, staff support services, and general transportation related services.

The overall support program interacts with U.S. Departments of Commerce, Defense, Interior, Transportation, Treasury, and Post Office. Close coordination of transportation facility planning with the counties is also maintained.

This program provides comprehensive transportation planning based on consideration of land use, socio-economic conditions and environmental factors. Other ancillary services such as management, administrative support, internal control, and computer coordination are provided to the three major transportation programs.

Financing for this program is provided on a pro-rata basis from the three special funds representing the three major activities of DOT. The current pro-rata shares are as follow: Airport Revenue Fund - 50 percent; Highway Revenue Fund - 41 percent; and Harbor Revenue Fund - 9 percent.

Cost data for the Overall Program Support for Transportation Facilities and Services program are shown in Table II-4.

TABLE II-4

INVESTMENT AND OPERATING COSTS

GENERAL ADMINISTRATION

	Fiscal Years							
	Actual 2003-04	Est. 2004-05	Rec. 2005-06	Rec. 2006-07	Projected 2007-08	2008-09	2009-10	2010-11
A. Costs of the Recommended Program[A/]								
Capital Investment	...	...	...	...	...	...	...	...
Operating	14.8	15.5	17.4	17.4	17.4	17.4	17.4	17.4
Total	14.8	15.5	17.4	17.4	17.4	17.4	17.4	17.4

A/ Expenditures in millions of dollars from all funds.

III. PROGRAM CHANGE RECOMMENDATIONS

No program change recommendations.

IV. EMERGING CONDITIONS, TRENDS, AND ISSUES

AIRPORT

A. Airline Lease Negotiations

Many of the airlines with flights to Hawaii are operating under terms and conditions of the existing airport-airline lease agreement. Each airline entering into this agreement is considered a signatory airline and the agreement governs fees and charges payable to the State for use of airport facilities. There have been no active negotiations on a new agreement for some time. While the State has a residual rate making methodology to set airline rates, landing fees and system support charges have been held at present levels since the early 1990s. This has resulted in use of the Airport's cash reserves to make up the shortfall in airline revenue. The financial uncertainly of the airline industry following the September 11, 2001 terrorist attacks has further challenged the Airport's ability to use its cash reserves to cover increased operating expenses and to meet coverage tests under its bond covenants.

B. Impact of September 11, 2001 - Aviation and Transportation Security Act

The tragic events of September 11, 2001, have permanently changed commercial aviation. As a result of these terrorist attacks, the FAA grounded commercial aircraft for three days and prevented foreign carriers from entering U.S. airspace for some time beyond that. Subsequently, President Bush signed the Aviation and Transportation Security Act, which established the TSA. TSA is responsible for overseeing the security of all modes of transportation, including aviation. Requirements of the Act include screening of all checked baggage, assuming airport security checkpoint responsibility from the airlines, and screening all checked baggage using an explosive detection system (EDS). While TSA has funded additional screening equipment, the State has had to fund infrastructure and other improvements to accommodate TSA's security screening operations.

C. Concession Leases

Passenger traffic has rebounded from the impacts of September 11, 2001. Airport concessionaires, some of

whom experienced sizable drops in gross receipts immediately after September 11th, have seen sales rebound. In the most recently issued concession agreements, provisions were incorporated to provide for periodic adjustment to the minimum annual guarantee (MAG) obligations and adjustment to percentage rents based on milestones. These provisions also allow for further MAG or rent adjustments in event of an economic emergency similar to that caused by September 11th. The In-Bond duty free concession, which suffered not only from events of September 11th, but also from the SARS outbreak in Asia, was re-issued in October 2003. The reissued concession contract provides for a reduced MAG, but with additional percentage rents should certain sales milestones be reached. The re-issued contract expires on May 31, 2006. The reduction in concession revenues from previous contract levels will continue to impact Airports finances for some time.

D. Aviation Activities

For Calendar Year 2003, passenger traffic statewide was down 4.5%, cargo and mail down 4.3%, and aircraft operations down 6.0% compared to Calendar Year 2002. At HIA, the passenger traffic was down 5.4%, cargo and mail down 6.3%, and aircraft operations down 6.7%. Even more telling, given Hawaii's dependence on Japanese tourism, the statewide international passenger arrivals in 2003 were down 7.5% when compared to the previous year.

E. Potential Capital Funding Sources

Airport System Revenue Bonds, Airport Improvement Program Discretionary Grants and Passenger Facility Charges are several potential capital improvement program project funding sources that could be utilized by Airports Division.

Airport System Revenue Bonds for airport capital projects were last issued in 1991. Debt levels have been managed by issuing refunding bonds and defeasing bonds with unencumbered funds from the Airport Revenue Fund. Compared to other airport systems, the State's system has a relatively low amount of outstanding bond debt per enplaned passenger.

FAA provides Airport Improvement Program Discretionary Grants for airport capital improvements. The amount of discretionary grants are determined annually by congressional appropriation. Airport operators submit

applications to fund specific projects with discretionary grants. These projects compete with projects submitted by other airport operators for the available amount of discretionary grants.

Since 1992, Passenger Facility Charges (PFC) have become an important source of funding for FAA approved airport capital projects throughout the country. Federal legislation allows the State to charge PFC only on overseas and international flights. Effective October 1, 2004, a $3.00 PFC is being imposed for each overseas or international passenger boarding at Honolulu International Airport, Kahului Airport, Kona International Airport at Keahole, and Lihue Airport. A total of approximately $42.6 million of PFC revenues will be applied to fund airport capital projects totaling $53.5 million. These PFC revenues will be used on a pay-as-you-go basis to the greatest extent possible to cover project costs.

F. Environmental Concerns

Environmental requirements for the airports system are increasing and ensuring compliance is becoming more complex and costly. Fines, which can be issued for violations, can total in the millions of dollars. The Environmental Protection Agency (EPA) has conducted various inspections at airports statewide every year since 1999. Letters from EPA regarding findings of violations and orders to correct deficiencies observed during these inspections have been received. Discussion of these violations and resulting fines are ongoing between EPA and DOT.

The Airports Division is responsible for ensuring that its own facilities are in compliance, together with those used by tenants (except for those tenants who have their own EPA permits). To do this, the division's environmental program is being modified to have environmental health specialists at each of the five major airports, with central coordination being done on the division level. At each of the major airports, environmental health specialists will conduct inspections, help meet permit requirements, and monitor various issues as required. At the division level, the following will be provided: 1) training in sampling and conducting inspections, 2) monitoring of existing and new environmental regulations, 3) coordination of efforts with EPA and the State Department of Health (DOH), and

4) development and maintenance of an environmental database.

HARBORS

A. Cruise Passenger Facilities

Hawaii's role in the cruise ship market continues to grow. Norwegian Cruise Lines (NCL) currently homeports two cruise ships, the Pride of Aloha and the Norwegian Wind, providing the State with year round inter-island service. A third ship, Pride of America, is anticipated by NCL to begin operations during 2005. Along with other cruise lines, the expected influx of visitors will have a positive impact upon the State's economy and increase demand for additional berthing and comfortable and efficient passenger terminals throughout the limited commercial harbors area.

Construction will soon begin to lengthen Pier 3 in Hilo and Pier 3 at Nawiliwili Harbor. These improvements will enable larger cruise vessels to berth alongside. A new cruise ship terminal at Pier 2 in Honolulu Harbor will soon begin construction as well. Proposed berthing and pier improvements at Kahului Harbor are being re-evaluated due to community opposition to harbor expansion.

B. Ferry System

The transportation of people over water has strong historical roots in Hawaii's development. Hawaii Superferry, Inc., a private ferry operator, has proposed to initiate a roll on/roll off high-speed daily inter-island ferry service for transport of passengers and vehicles, including cars, trucks and buses. Passengers may bring on certain amounts of baggage and vehicles may contain cargo, produce and other items; however, the ferry is not intended to transport general commodities, containerized cargo or other cargo in bulk. Operations are planned between the harbors of Honolulu, Kahului, Nawiliwili and Kawaihae. Service is estimated to begin in early 2007 starting with one vessel during the first year and a second vessel is expected in the following 18-24 months. Fast ferry service will provide an alternative means for residents and visitors to travel between the islands as well as a transportation alternative to local producers for shipping goods to Oahu and the neighbor islands. Initial improvements are

proposed for Honolulu, Kahului and Nawiliwili. Subsequent improvements will be made to Kawaihae. While there is support for the alternative means of travel, opponents to ferry operations have raised environmental concerns, conflicts between recreational and commercial use of the harbors, and adequacy of infrastructure to support the expected volumes of passengers and cargo.

C. Cargo Facilities/Growth Issues

The continued growth in cargo has resulted in new cargo operations and anticipated introduction of a new cargo operator in 2005. Matson Navigation Company currently operates seven large container ships between Honolulu Harbor and the west coast of the United States with ships arriving at Honolulu Harbor three times a week. In October 2003, Matson implemented a new dedicated automobile roll-on/roll-off service every 14 days between Oakland, California and Honolulu and Kahului, Hawaii. Horizon Lines operates seven container ships between Honolulu Harbor and the west coast of the United States, with ships arriving at Honolulu Harbor twice a week, one of which proceeds on to the Far East. Young Brothers Limited operates inter-island vessels at Piers 39 and 40 in Honolulu Harbor and at most of the neighbor island harbors. In 2005, PASHA Hawaii Transport Lines LLC will begin providing services through use of the first modern pure car-truck carrier ever built in the United States. The ship will be designed to carry approximately 4,000 vehicles on ten decks. The introduction of PASHA along with need to accommodate cargo, ferry, and cruise line growth places imposes tremendous demands on the limited waterfront space at Honolulu Harbor.

Current projections indicate that additional cargo yards will be required in Honolulu for foreign cargo by 2006. Similarly, additional cargo yards for domestic cargo will likely be required by 2011. There are also on-going plans to develop the Honolulu waterfront for commercial purposes. This would further limit use of lands near Honolulu Harbor for maritime purposes and make it increasingly difficult to meet growing maritime needs. Fort Armstrong, Honolulu Harbor's foreign container terminal, remains under jurisdiction of the Hawaii Community Development Association (HCDA). The long term future of Piers 1 and 2 as envisioned by HCDA is a mixed maritime use area with reduced cargo activity. Consequently, development of the former Kapalama Military Reservation site and Sand Island to meet near term container yard requirements is a high priority.

Additional future expansion areas will also likely be required.

Neighbor-island ports face similar growth challenges. Beginning in the Fall of 2004, Matson began providing direct service to Kahului Harbor utilizing ocean-going ships. Matson is also planning to provide direct service to Hilo Harbor utilizing the same vessel. Discussion is also underway with a woodchip operator who is interested in using Kawaihae Harbor to export eucalyptus woodchips to foreign markets. Due to limited pier facilities, private development of a berth for woodchip carrying vessels is a possibility.

D. Oil Contamination

The Harbors Division has been working with DOH and Principal Responsible Parties (PRP) to address petroleum ground contamination in Honolulu Harbor. The U.S. EPA has monitored this effort.

Long-term mitigation measures may be required from PRP. Determining the appropriate level of remediation will require further investigation and response activities by PRP. PRP is also tasked with the obligation to prevent future violations and implement long-term remediation measures.

E. Seaport Security

The Harbors Division continues to seek support for its security related manpower, infrastructure, and equipment needs to meet substantial federal requirements imposed by the Maritime Transportation Security Act of 2002. As part of its port security program, the Division submitted facility security plans to the U.S. Coast Guard in December 2003. These plans have been under review and most have received final approval. Establishing Facility Security Officer positions is required by federal regulations and is a priority measure to better manage the security regime at each principal harbor. The increased security requirements were implemented on the assumption that a security organizational structure would be in place with responsibilities clearly designated. The Division urgently needs the additional manpower and financial resources to properly establish and staff its development and management of the port security program and comply with all applicable federal security requirements.

F. Financial Outlook

In the future, tariff structures will probably need to be evaluated and revised to ensure that sufficient revenue is generated to meet the Harbor Revenue Bond compliance tests and maintain financial health of the statewide harbors system. Wharfage tariffs have remained static since 1997 while harbor capital improvement costs to maintain existing facilities and develop infrastructure and facilities to keep up with maritime demand have grown. Continued development of the harbors system is dependent upon our financial ability to underwrite the capital improvement costs. The Harbors Division also recognizes the need to evaluate its business practices to determine if greater efficiencies and financial benefits can be obtained through new procedures, improved management and other operational changes to better serve our maritime customers and the general public.

G. Challenges to Future Growth of the Statewide Harbors System

While the Harbors Division continues to develop expanded facilities to meet cargo needs of the community at large, the Division has encountered specific community concerns to pier expansion at Kahului Harbor. In particular, there are conflicts between the need for continued harbor development to accommodate growth and the impact such expansion will have on ocean recreational use. Expansion and development of other ports may raise similar conflicts with recreational users that have in the past utilized non-developed commercial harbor properties and areas that are now required to meet harbor growth.

Sea transportation provides the State with the bulk of its imported goods and its primary means for exporting local products. The statewide harbors system must have the ability to support shipping and maritime commerce. This is a critical economic lifeline to the State. Harbor facilities are limited, and as maritime needs increase, the challenge will be to accommodate this growth balanced against the community's desire to permit other uses of harbor areas.

HIGHWAYS

A. Congestion

The Highways Division has undertaken numerous projects to alleviate traffic congestion throughout the State. In addition to increasing the capacity of our highways, we are also looking into ways of decreasing traffic demand by promoting ride sharing, flexible working hours, van pooling, car pooling and use of alternative modes such as buses (both public and private) and bicycling.

The Highways Division has moved toward using various alternatives in lieu of building more highways. For example, the Zipper lane extension project will enhance highway capacity for in-bound morning traffic along the Interstate H-1 Freeway. A Freeway Service Patrol program, which will utilize a series of roving tow trucks along Oahu's freeway system to assist in promptly handling minor freeway incidents, will begin operation in 2005. Also, the Freeway Management System project will look at expanding our ability to identify incidents (with loops, CCTV cameras, and communication backbone) and timely communicate relevant commuter information to motorists.

B. Safety

The Highways Division is developing a Safety Management System (SMS) to identify effective highway safety strategies and projects. Current safety programs include implementing intersection improvements and installing/upgrading traffic signals, guardrails and drainage improvements. We are implementing a bridge seismic retrofit program to enable bridges on Hawaii and Oahu to better withstand earthquakes and other soil movements. Safety analysis for each highway project is commenced at the earliest stage of project development to ensure consideration of identified areas of concern.

C. Environmental and Public Involvement

Hawaii has a unique and fragile environment, requiring stewardship in promoting, preserving, and enhancing the natural assets of the islands and striving to protect their beauty and sensitive areas. The development of highways facilities must be balanced against the need to protect the environment. The Highways Division continues to take a proactive approach in fulfilling its Federal Clean Water Act requirements.

Environmental assessment of our projects and mitigation of impacts is required prior to construction of our projects. The Highways Division will continue to hold informational meetings with community groups, seeking their input on current and future projects in their areas.